In the Supreme Court of the United States

OCTOBER TERM, 1940.

No. .....

THE HYGIENIC PRODUCTS COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION.

OPINION BELOW.

The opinion of the Circuit Court of Appeals appears in the Record at pp. 31, 32 and 33 and was entered April 12, 1940.

JURISDICTION.

The decree of the Circuit Court of Appeals was entered April 12, 1940 (R. 31-33). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended, 28 U. S. C. A., Section 347 (a).

STATEMENT OF CASE.

The question involved in this case is whether this taxpayer should be denied the right to deduct from its tax liability to the United States taxes paid by it to a foreign government within the following provisions of the Revenue Act of 1934:

Section 41. General Rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or

calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

Section 131. Taxes of foreign countries and Possessions of the United States.

(a) Allowances of credit.—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this chapter shall be credited with:

(1) In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States;

* * *

(d) Year in which credit taken—the credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possessions of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possessions of the United States accrued, the credits for all subsequent years shall be taken upon the same basis and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

* * *

This petitioner for a number of years prior to the enactment of the Canadian income tax has done business there. Its method of doing business there has been the same. The first opportunity the petitioner had to make an election under Section 131 was in 1934. There was no attempt on the part of the petitioner to alter its accounting procedure when it made its election. The Commissioner and the Courts below have attempted to justify the disallowance of the deduction claimed by arbitrarily disapproving of the label "hybrid system" of accounting and just as arbitrarily labelling petitioner's accounting method as the "accrual method."

In the case of *Morris-Poston Coal Co. vs. Commissioner of Internal Revenue*, 42 F. (2d) 620, it was held:

"1. Under income tax law, selection of system of keeping books is primarily for taxpayer.

4. Taxpayer customarily employing combination of cash and accrual methods in bookkeeping does not change methods merely because having changed character of business, he classified new income in accordance with honest judgment."

Fleischmann Construction Company, et al. vs. United States to the use of Forsberg, et al., 270 U. S. 349, the sixth syllabus of the case held:

> "The strict letter of an Act must yield to its evident spirit and purpose, when this is necessary to effectuate the intent; and unjust or absurd consequences are to be avoided if possible."

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

1. In holding that the petitioner's accounting method was the accrual method.

2. In holding that the petitioner's accounting method does not clearly reflect income unless it conforms to "one method."

3. In holding that the petitioner should have recognized its tax liability to Canada before it was determined.

4. In affirming the decision of the United States Board of Tax Appeals.

ARGUMENT.

I.

This Court has repeatedly undertaken to resolve doubts which inevitably follow from conflicting decisions in lower Federal Courts. This has been demonstrated recently in *Raybestos-Manhattan, Inc. v. United States*, 296 U. S. 60 (1935) and *Founders' General Corp. v. Hoey, Collector of Internal Revenue*, 300 U. S. 268 (1937), wherein this Court granted certiorari.

In the case of *Arthur Jewett Connor v. U. S.* (1937—D. C. N. H.), 19 F. Supp. 97, the taxpayer was awarded a refund representing a tax paid to the Dominion of Canada on income from sources in that country which was received by the taxpayer during the year 1932, which sum the taxpayer claimed should have been credited on the income tax assessed against him by the Commissioner of Internal Revenue at Portsmouth, New Hampshire.

The question presented was whether or not the taxpayer was entitled to a credit under Section 131 of the Revenue Act effective in 1932 against the income taxes paid by him to the United States for the year 1932 of the income taxes paid by him to the Canadian Government in 1934 for the year 1932, when the taxpayer is on the cash basis and did not signify in his income tax return for 1932 his desire to have the benefits of said section.

All of the income upon which the Canadian tax was paid was included in the gross income shown on the Federal income tax return which the taxpayer filed with the Commissioner for the year 1932 and a tax was assessed thereon.

The Government contends that the credit was rightfully disallowed by the Commissioner of Internal Revenue under the Subdivision (a) of Section 131 because the taxpayer did not claim the credit on his original 1932 tax return.

The Commissioner disallowed the claim for refund and the claim was prosecuted to the District Court of New Hampshire. The Court in its opinion held:

> "I hold that the Petitioner is not barred from obtaining a refund by reason of the fact that he did not 'signify in his original return his desire to have the benefits of Section 131 (a).' The statute should not be construed to require the impossible."

The Court came to the conclusion by setting forth its reasoning as follows:

> "What I believe to be the law concretely applied to the facts in the instant case leads to the following conclusions: The Petitioner filed in his original return for 1932 the amount of income derived from operations in Canada and the Commissioner assessed a tax thereon amounting to $4,820.34. At that time the Petitioner had no reason to believe that a tax thereon would be assessed by the Canadian Government as no such tax had been theretofore assessed.
>
> "The petitioner was not called upon to make any election under Section 131 (a) as the word 'election' signifies a choice between two or more methods. The Petitioner in filing his 1932 returns did what any honest taxpayer would do with the knowledge at hand. He included the Canadian income in his tax return. The first information he had that he was liable to an assessment under the Canadian laws came to him in the fall of 1933. After he had obtained advice and became satisfied that the tax was legally assessed against him he paid the same on February 6, 1934."

As can be seen, the facts and circumstances under which the Petitioner in the instant case claims the right to a deduction are practically the same as those under which the Dis-

trict Court of New Hampshire allowed the taxpayer a refund.

The Government did not prosecute an appeal to the First Circuit in the *Connor* case.

We, therefore, find a situation whereby a taxpayer in the Sixth Circuit is denied the benefits of Section 131 and a taxpayer of the First Circuit is permitted to avail himself of them.

II.

The Board of Tax Appeals and the Circuit Court of Appeals in the instant case cite numerous decisions by this Court as being controlling in the determination of the question herein involved. It is respectfully urged that the decisions of this Court cited by the Board of Tax Appeals and the Circuit Court of Appeals are not applicable in that in each instance there was a departure from the taxpayer's customary accounting method for the obvious purpose of avoiding a tax. In the instant case the bona fides of the taxpayer were not and cannot be questioned. It attempted to avail itself of the provisions of Section 131 of the Revenue Act at the first opportunity. It was justified in its resistance of the Canadian income tax because of the fact that no demand or request was made by the Canadian Government for years prior to 1930 and during which this petitioner had conducted business in the Dominion of Canada in the same manner.

During the years in question in the instant case this petitioner reported as income to the United States Government all of its income, including its income from sources within the Dominion of Canada, without making any deduction or allowance for taxes or tax liability to the Dominion of Canada. On this amount taxes were paid in each of the years involved to the United States Government.

III.

The petitioner herein urges that a failure to grant the relief sought would result in double taxation specifically sought to be avoided by the enactment of Section 131 of the Revenue Act. It is significant that prior to 1924 the broad aspect of said section as it relates to the election to be made by the taxpayer as to when he may avail himself of its provisions were not included. This Court has on several occasions throughout its history in interpreting tax laws steadfastly held that tax laws should be construed liberally in favor of the taxpayer. The following are a few cases on that proposition:

In *Bowers vs. Fuller*, 273 U. S. 346, the third syllabus reads as follows:

> "Taxing laws are to be interpreted liberally in favor of the taxpayer."

In *Old Colony Railroad Company vs. Commissioner of Internal Revenue*, 284 U. S. 552, 76 Fed. 485, the fifth syllabus reads as follows:

> "Terms used in tax statutes are, in case of doubt, to be given construction most favorable to the taxpayer."

Darby-Lynde Co. vs. Alexander, Collector of Internal Revenue (C. C. A. Tenth Circuit), 51 F. (2d) 56, says:

> "4. Court must ascertain true meaning of statute where language is doubtful, or where strict construction would lead to injustice or absurd results."

Commissioner of Internal Revenue vs. Wilson (C. C. A. Tenth Circuit), 60 F. (2d) 501, states:

> "2. Taxing act, including provisions of limitation embodied therein, should be liberally construed in taxpayer's favor."

In Volume 3 of *Paul Mertens' Law of Federal Income Taxation*, Sections 31.07 and 31.08, we find the following discussion:

"31.07.—*Election as to Year in Which the Credit for Taxes Is to Be Taken.* The taxpayer is given an option to take the credit for taxes and also an option as to the year in which it shall be taken. It may be taken in the year in which the tax is paid or the year in which the taxes of the foreign countries or possessions of the United States accrued. This election is 'irrespective of the method of accounting employed in keeping his book.' (37)[1] This provision represents a departure made in the 1924 Act from previous statutes which required the credit to be taken by a taxpayer on the cash basis in the year in which the taxes were paid (38)[2] and by taxpayers on the accrual basis in the year of accrual of the taxes. (39)[3] This option is subject to the adjustments elsewhere discussed. (40)[4] If the taxpayer elects to take the credit in the year of accrual, he is bound by the election and the credit for all subsequent years must be taken on the same basis. Furthermore no portion of the taxes will be allowed as a deduction in the same or any succeeding year."

"31.08. *When Foreign Income and Profits Taxes Should Be Credited.* Taxpayers on the accrual basis should take the credit for foreign taxes in the year

---

"[1] (37) 1934, 1932, 1928 Acts, Sec. 131 (d); 1926 and 1924 Acts, Sec. 222 (c), 238 (c); Reg. 77, Art. 696; Reg. 74, Art. 697; Reg. 69 and 65, Art. 387.

[2] (38) 1924 Act, Sec. 222 (c), 238 (c). As to the 1918 Act, see *Chester D. Griesemer*, 10 B. T. A. 386, and I. T. 1630, C. B. II-1, p. 163, involving a net loss question; as to the 1921 Act, see *James R. Hatmaker*, 15 B. T. A. 1044; *David A. Cunningham*, 9 B. T. A. 1050; *Albert D. Hewinson*, 1 B. T. A. 1080.

[3] (39) L. O. 987, C. B. 2, p. 196; A. R. M. 173, C. B.-I-1, p. 197.

[4] (40) See Sec. 31.09."

in which the taxes accrue; (41)[1] taxpayers on the cash basis should take the credit for foreign taxes in the year in which the taxes are paid. However, taxpayers on the cash basis are given the privilege of taking the credit for foreign taxes, if election to do so is made, in the year of accrual, in which event the credit for foreign taxes for subsequent years must be taken upon the same basis. (42)[2] In this connection, the question to be decided for purposes of the foreign tax credit provision, as well as for other purposes, is whether the taxpayer is on the accrual basis. (43)[3] The principles of accrual are the same whether a foreign tax is to be deducted or to be applied as a credit, and the treatment of the subject is, therefore, consolidated elsewhere in this book. (44)[4] The general rule is that foreign taxes accrue where all the events occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. Even a contest and denial of liability will not postpone accrual. (45)[5]"

"[1] (41) See *Purdy & Henderson Co.*, 4 B. T. A. 70; *Ruud Mfg. Co. v. Comm.*, 45 F. (2d) 63 (C. C. A. 3rd, 1930), to the effect that the credit for taxes paid to Canada in 1921 assessed for 1918 and 1919 under the Business Profits War Tax Act of 1916, is allowable as a credit in 1921 where the taxes did not accrue or become payable until assessment notices were received in 1921.

[2] (42) G. C. M. 9459, C. B. X.-1, p. 169.

[3] (43) *Niles-Bement Pond Co. v. U. S.*, 281 U. S. 357, 74 L. Ed. 901, 50 S. Ct. 251 (1930).

[4] (44) See Sec. 25.31.

[5] (45) *Russell-Miller Milling Co. v. Helvering*, 69 F. (2d) 392 (App. D. C., 1934); *Carter Rice & Co.*, 28 B. T. A. 687, pointing out the distinction between the 1921 and subsequent acts."

For all of these reasons, petitioner suggests that the decision below should be reviewed by this Court.

Respectfully submitted,

MEYER A. COOK,

Solicitor for
The Hygienic Products Company.